Elements and Functions of a Market Program To Reduce CA Greenhouse Gas Emissions

Prepared by

Lawrence H. Goulder

The Market Advisory Committee's Focus

The focus is on one specific market approach: tradable emissions allowances ("Cap and Trade")

- Other market approaches (e.g., tax credits for R&D, emissions taxes) may be considered by California's Air Resources Board, but not by the MAC

Cap and trade is to be used alongside other regulatory approaches

- It does not replace use of existing strict environmental standards (such as building codes, appliance standards)
- Nor does it prevent implementation of new direct regulations (e.g., requirements on methane releases from landfills, CO_2/mile limits, etc.)
- It is one component of California's overall effort

Why Cap and Trade?

- Allows given targets for emissions reductions to be achieved at lower cost to society than would be possible without allowance trades

Key Elements of a Cap and Trade System

1. Establish an overall cap on emissions covered by the program
   - “overall cap” is not the same as the statewide emissions target
2. Allocate emissions allowances (emissions permits) to facilities covered by the program
3. Allow for trading of allowances

What Does Trading Accomplish?

Compare with a situation where facilities had fixed limits on their emissions

Voluntary trading – the buying and selling of emissions allowances – leads to cost reductions

- Sources for which it is especially costly to cut emissions can purchase additional allowances and thereby avoid high costs
- Sources for which it is relatively inexpensive to cut emissions will find it advantageous to sell allowances and take on extra responsibilities

Both buyers and sellers benefit.

California benefits, too, because more of the work is carried out by facilities that can reduce emissions most cheaply.

Note

Introducing the market program does not imply higher emissions:

- Overall emissions under the program are determined by the number of allowances allocated. Allowing trading is not offering an unlimited license to pollute.

- A well-designed program should control emissions "leakage."

By establishing a price of emissions allowances, the program helps level the playing field -- encourages development of clean technologies

The Committee Is Committed To …

- Making use of lessons from experiences with cap and trade programs in US and abroad
- Designing the Cap and Trade program so that it complements existing environmental regulations as well as whatever new regulations are introduced to meet the California targets
- Designing the program to help encourage development of new, low-emissions technologies, and use of renewables
- Designing the program so that it meets various environmental concerns, including concerns about environmental justice
  - No softening of the State's other rigorous environmental laws to improve air quality, enhance water quality, and prevent local pollution. (In fact, the program is likely to cause further reductions in local pollutants.)
  - No creation of "hot spots"

Some Key Design Issues

- What sectors to cover?
- What greenhouse gases to include?
- How should allowances be allocated?
- What activities, if any, should qualify for “offsets?”
- Should a ceiling price (“safety valve”) be established?

Final Comment

The program will be designed to help reduce the cost of meeting California's emissions-reduction targets for 2020, in a way consistent with broader environmental concerns and concerns about fairness